
Achieving Successful Concessions

Building Critical Assets

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What Are Concessions?

- Any arrangement in which a firm obtains from the government the right to provide a particular service under conditions of significant market power.

What Are Concessions?

- A long-term agreement between a government entity and a private company, under which the private company provides, or contributes to the provision of a public service
- Private company receives a revenue stream - from government budget allocations, from user charges, or a combination - dependent on the availability and quality of the contracted service
- Private company must generally make an investment in the venture
- In addition to budget allocations, the government may make further contributions, such as providing land; contributing existing assets; or providing guarantees that enable risk to be shared between the government and the private company
- At the end of the concession, the assets normally revert to government ownership



Types of Concessions

- It is about allocation of risk
 - Management contracts with incentive payments.
 - Leases.
 - Pure concessions, Build-Operate-Transfer

Why Use Concessions?

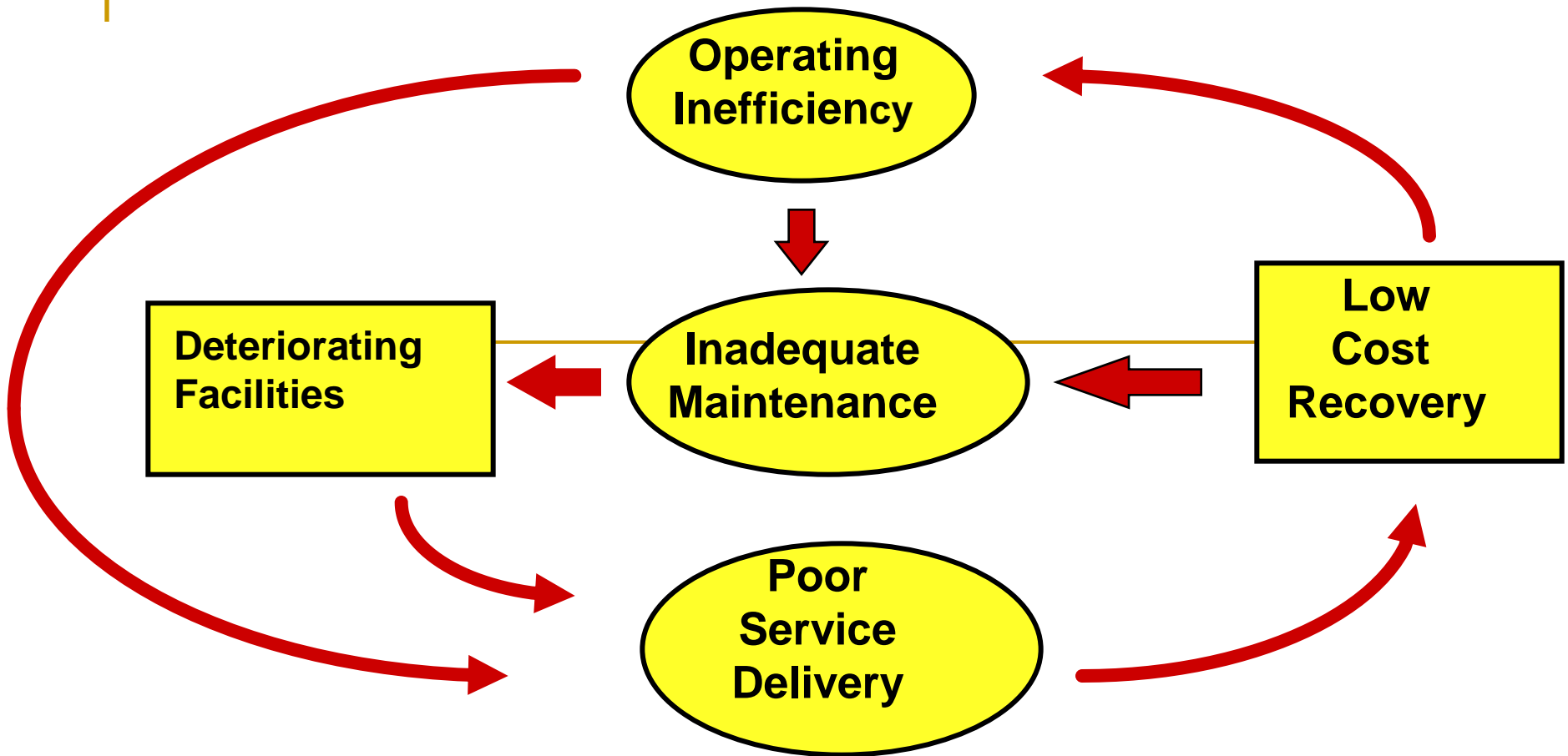
- They facilitate the regulation of natural monopolies.
 - In markets that are naturally competitive, direct competition between firms can usually work well without recourse to concessions.

Why Use Concessions?

- **Improved Efficiency & Service** - Higher quality of services & lower per unit costs
- **Greater Technology Transfer** - Access to new technologies and experienced management not currently available through the public monopoly
- **More Room for Government Borrowing** - Free up resources in public budgets for other services
- **Accountability** - More transparency and accountability for service delivery; improved monitoring and supervision of projects



Why Use Concessions?



Need to Strike a Balance

- Private operators and their financial backers seek to reap adequate returns in sufficiently stable environments.
- Public parties want to limit possible abuses of monopoly power by the private operator.
 - Maintenance of appropriate environmental and health standards.
 - Likely to impose certain conditions in the pursuit of social objectives.

Brief History

- Private companies developed much of the early water in France, Britain and the United States.
- Local private firms were responsible for developing most of the electricity utilities in Brazil, Chile, Costa Rica and Mexico.
- In France the king granted concessions for roads and bridges.



Challenges for Public Sector

- At the macro level
 - Prioritizing investment
 - Understanding bankability
 - Reporting and accounting
- At the project level
 - Procurement
 - Procurement procedures
 - Tender specifications
 - Project management
 - Understanding deal structure



Need to Take on New Roles

- Concession stakeholders within and outside government to take on new roles or perform existing roles in improved ways.
- Government must ask a series of key questions:
 - Are the institutional and legislative frameworks in place to support concessions?
 - Are the relevant levels of government prepared to relinquish or revise their roles?
 - Are the relevant levels of government prepared to delegate some control to private partners within defined policy and regulatory parameters?
 - Does each institution have the funding, staff, training, and equipment required to discharge its functions?
 - Does each institution understand its role and know how to develop the procedures for accomplishing this role?
 - Is there a key stakeholder - i.e., a champion - with the capacity and the political will to lead and drive the reform agenda forward?

Government Responsibilities for Concessions

- Framework
- Identifying and analyzing projects
- Enabling measures for specific projects
- Designing concessions
- Awarding concessions
- Regulating concessions

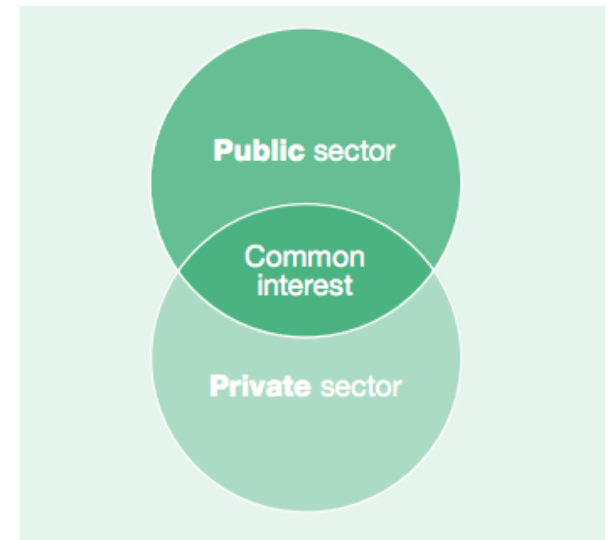
Why Concessions Fail

- Inadequate assessment resulting in over-construction
 - Aggravated by declining economic conditions
- Politicization of projects
- Misallocation of risk
- Systematic financial change
- Judicial/political capriciousness



Concession Principles

- Value for Money (VfM) and Whole-Life Costing.
 - Government should seek the best value, and not necessarily the lowest (or highest) initial price
- Risk Transfer
 - Should be borne by the party best capable to manage the risk
- Performance Specifications
 - Criteria need to be clearly outlined and private party should be made responsible for delivering
- Competition
 - Open and Transparent



Keys to Success

- Political Support
- Enabling Environment
- Expertise
 - Consejo Nacional de Concesiones
- Project Prioritization & Preparation
- Deal Flow and Standardization of Agreements
- Clear and Transparent Procedures for Awarding Concessions
- Capacity Building



Latin American Concessions

- Early Problems (Brazil)
 - ❑ Absence of appropriate legal and regulatory framework.
 - ❑ Ineffective dispute resolution.
 - ❑ Renegotiated concessions.
 - ❑ Bidding problems.
 - ❑ Lack of political consensus.
 - ❑ Financing bottlenecks and failure to address lender issues.



Latin American Concessions

- Later Success (Chile)
 - ❑ Perceived as one of the most successful and effective toll road schemes in the world.
 - ❑ More than 3,000 km of highways concessioned.
 - ❑ Major source of foreign investment.
 - ❑ More than \$1.5 billion in project bonds raised in international financial markets.



Key to Chilean Success

- Solid Legal and Regulatory Environment
 - Technically competent
 - Immune from outside pressures
- Financial Risk Management
 - Minimum revenue guarantees
 - Careful assignment of risk
- Stakeholder Consultation
 - Community-level consultations and conflict resolution forums



Chicago Parking Meter Concession

- More than 36,000 meters generating about \$19 million annually
 - That's a lot of quarters!
- City of Chicago awarded a 75-year concession to a consortium in December 2008
 - Chicago received an upfront payment of \$1.15 billion



Terms of the Deal

- City of Chicago
 - Retains rate setting authority
 - Parking enforcement & fine collection
 - Number of meters
- Chicago Parking Meters, LLC
 - May supplement ticketing enforcement
 - Must replace and upgrade entire meter system



Conflicts

- Operational Problems
 - ❑ Concessionaire underestimated resources required to reprogram meters to reflect higher rates and repair or replace broken meters
 - 250 meters failed in a single day
 - ❑ Spike in repair times
- Political Problems
 - ❑ City Council questioned contract
 - ❑ Calls for a consumer fraud investigation
 - ❑ Inspector General issued a report that the City received too little for the concession



Resolution

- Operational Problems Resolved
 - Addition of staff reduced repair response times significantly
 - Concessionaire replaced all meters by end of 2009 – two years ahead of schedule
- Political Problems Mitigated
 - Mayor Daley took responsibility for the implementation glitches
 - IG report proved inaccurate
 - Underestimated annual capital expenditures
 - Low discount rate in calculating NPV



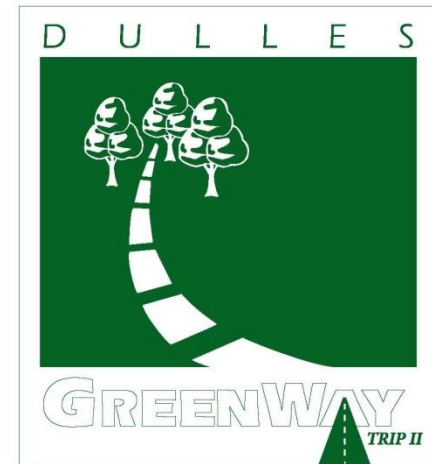
Dulles Greenway Toll Road

- Toll road in Northern Virginia
 - Design-Build-Operate-Finance
 - Opened September 1995
 - Reverts to State of Virginia in 2036
- \$350 million
 - \$40 million Equity
 - \$310 million Debt
- 14 miles (22.5 km)
- Runs Between Dulles Airport in East and Leesburg, Virginia to the west



Dulles Greenway Conflict & Resolution

- Initial revenue insufficient to service debt
 - Began facing default in 1996
 - Competition from “free” parallel Virginia Route 7
 - Anticipated economic development slow to occur
- Bankruptcy a Possibility
- Debt Restructured in 1997 to Avert Bankruptcy
- Concession extended 20 years to 2056



Project Level Advice

- Budget appropriately for advisors
 - Your private counterpart will certainly do so
- Don't leave negotiations to the lawyers
 - A good lawyer needs a good client
- Be close enough of the deal to understand your risks
 - Make sure you know what you don't know
- Understand the private sector's risks in other deals
 - If a risk is unbankable elsewhere, it will usually be unbankable here
- Establish clearly who can make decisions
 - Private sector will expect to deal with counterparts with authority to negotiate
- Never lose sight of value for money
 - This is the reason you are doing the project

Strategic Level Advice

- Demonstrate political commitment
 - Unless bidders believe, your plans will not be credible
- Establish a program; create a pipeline
 - Bidders invest significant sums in the competitive phase; they must see the prospect of success
- Market the program
 - You are in competition for bidders' interest
- Continue to support and centralize authority in CNC
 - Individual ministries may procure one concession in lifetime; for bidders, it's their life
- Consider framework procurements for legal, technical and financial advisors
 - Appropriate advisors are a key factor for success

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